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EXCEPTION

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August 1, 2002

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Arizona Corporation Commission
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Re: Docket No. E-00000A-02-0051; E-01345A-01-0822; E-00000A-01-0630; E-01933A-02-0069; E-01933A-98-0471

In the matter of the Consolidated Generic Proceedings Concerning Electric Restructuring

Dear Ms. Cole:

Enclosed for filing in the above-captioned proceeding are the original and eighteen (18) copies of the Joint Exceptions of Sempra Energy Resources and Southwestern Power Group, II, L.L.C. to Certain Portions of Recommended Opinion and Order on Certain Track "A" Issues. Also enclosed are two additional copies to be conformed and returned to our office in the self-addressed, stamped envelope provided for your convenience.

Please let me know if you have any questions, and thank you for your assistance.

Sincerely,

Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

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Arizona Corporation Commission
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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE GENERIC) Docket No. E-00000A-02-0051
PROCEEDINGS CONCERNING ELECTRIC)
RESTRUCTURING ISSUES)

IN THE MATTER OF ARIZONA PUBLIC) Docket No. E-01345A-01-0822
SERVICE COMPANY'S REQUEST FOR A)
VARIANCE OF CERTAIN REQUIREMENTS OF)
A.A.C. R14-22-1606)

IN THE MATTER OF THE GENERIC) Docket No. E-00000A-01-0630
PROCEEDING CONCERNING THE ARIZONA)
INDEPENDENT SCHEDULING)
ADMINISTRATOR)

IN THE MATTER OF TUCSON ELECTRIC) Docket No. E-01933A-02-0069
POWER COMPANY'S APPLICATION FOR A)
VARIANCE OF CERTAIN ELECTRIC)
COMPETITION RULES COMPLIANCE DATES)

IN THE MATTER OF THE APPLICATION OF) Docket No. E-01933A-98-0471
TUCSON ELECTRIC POWER COMPANY FOR)
APPROVAL OF ITS STRANDED COST)
RECOVERY)

JOINT EXCEPTIONS OF SEMPRA ENERGY RESOURCES
AND
SOUTHWESTERN POWER GROUP, II, L.L.C.
TO CERTAIN PORTIONS OF RECOMMENDED
OPINION AND ORDER ON
TRACK "A" ISSUES

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TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	THE COMMISSION SHOULD NOT IMPEDE ITS ABILITY TO CREATIVELY AND CONSTRUCTIVELY RESOLVE TRACK "B" ISSUES INCIDENT TO A RESOLUTION OF TRACK "A" ISSUES	1
	A. <u>An Integrated Overview.</u>	1
	B. <u>The Potential Discordant Element.</u>	3
	C. <u>A Suggested Clarification or Correction.</u>	5
III.	THE LANGUAGE OF THE RECOMMENDED OPINION AND ORDER SHOULD BE MODIFIED TO CLARIFY AND PROVIDE THAT THE PHRASE "COMPETITIVE PROCUREMENT PROCESS" INCLUDES THE PROCUREMENT OF POWER THROUGH PRUDENT, ARM'S LENGTH BILATERAL CONTRACTS RESULTING FROM PRUDENT, ARM'S LENGTH NEGOTIATIONS	6
IV.	MISCELLANEOUS	7
V.	CONCLUSION	9

I.

INTRODUCTION

Pursuant to Rule R14-3-110(B) of the Commission's Rules of Practice and Procedure, Sempra Energy Resources and Southwestern Power Group II, L.L.C. ("Sempra/ SWPG") submit the following Exceptions and related suggestions to certain of the Findings of Fact and Ordering Paragraphs contained in the recommended Opinion and Order prepared by the Commission's Chief Administrative Law Judge ("CALJ") in Track "A" of the above-captioned consolidated proceedings. In this regard, Sempra / SWPG would note that many of their Exceptions are in the nature of suggested clarifications rather than objections.¹ Overall, they believe that the CALJ has done a commendable job in identifying and discussing those issues which are appropriate for resolution in Track "A," and those which are not.

II.

**THE COMMISSION SHOULD NOT IMPEDE ITS ABILITY
TO CREATIVELY AND CONSTRUCTIVELY RESOLVE
TRACK "B" ISSUES INCIDENT TO A RESOLUTION OF
TRACK "A" ISSUES**

A. An Integrated Overview.

As the following excerpts illustrate, in her recommended Opinion and Order, the CALJ has correctly recognized that Track "A" and Track "B" issues are both conceptually and functionally interrelated, and that the manner of resolution of the former must be sensitive to the effects upon the latter; and vice versa.

¹ Webster defines "exception" as meaning "objection." The Merriam Webster Dictionary (1997).

1 “We find that due to circumstances outside our control or the control
2 of any party, and in order to protect the public interest, we must take
3 further action to regulate the transition to competition. We want to
4 take action in a manner that is fair to all parties and that protects
5 ratepayers. . . Therefore, the wise course of action is to try to
6 minimize the effects and figure out a way to move forward that will
7 ultimately result in a market structure that performs efficiently and
8 rationally, and that will result in the benefits that were promoted in
9 the move to competition. . .” [Opinion and Order, page 22, lines 21-
10 26] [emphasis added]

11 * * *

12 “Therefore, we find that the public interest requires that the
13 divestiture requirement found in R14-2-1615(A) and our extensions
14 of that requirement until January 1, 2002, found in Decision Nos.
15 61973 and 62103, must be modified. . . Recognizing this, it is
16 incumbent upon all parties to work together in such a manner that
17 will allow competition and its expected benefits to develop in
18 whatever timeframe is needed to make it successful, while ensuring
19 that the Citizens of Arizona have safe, reliable and fairly priced
20 electric power . . .” [Opinion and Order, page 23, lines 2-10]
21 [emphasis added]

22 * * *

23 “Further, we will modify R14-2-1606(B) and Decision Nos. 61973
24 and 62103's requirement that 100 percent of power purchased for
25 standard offer service shall be acquired from the competitive market,
26 but with at least 50 percent through a competitive bid process; but
27 effective upon the implementation of the outcome of Track B, we will
28 require APS and TEP to acquire, at a minimum, any required power
that cannot be produced from its own existing assets, through the
competitive procurement process as developed in the Track B
proceeding. The amount of power, the timing, and the form of
procurement shall be determined in the Track B proceeding. We
believe that in this way we can encourage a phase-in to competition,
encourage the development of a robust wholesale market for
generation, and obtain some of the benefits of the new Arizona
generation resources, while at the same time protecting ratepayers.”
[Opinion and Order, page 23, lines 14-21][emphasis added]

1 What these excerpts further reflect, as does the overall tenor of the recommended Opinion
2 and Order, is a desire to move the phase-in of competition forward as quickly as possible, consistent
3 with sound public policy. Thus, any artificial constraints or barriers to such phase-in should be
4 avoided. Further, such phase-in will require an ongoing synchronized interface between the Track
5 “A” and Track “B” proceedings, and the manner of resolution of issues in each.

6
7 **B. The Potential Discordant Element.**

8 However, set against the integrated and harmonious approach depicted above is a discordant
9 element which requires clarification or correction, as the case may be. This appears in the midst of
10 the CALJ’s discussion of the generation asset transfer or divestiture requirement issue where she
11 recommends as follows:

12
13 “... Accordingly, we will modify Decision Nos. 61973 and 62103 to
14 stay the asset transfer provisions until we can conclude that the
15 wholesale market is workably competitive, until at least July 1, 2004,
16 at which time we will reassess the appropriateness and timing of
17 divestiture.” [Opinion and Order, page 23, lines 10-13] [emphasis
18 supplied]

19 There are several problems with the underscored portion of this particular recommendation.

20 First, the July 1, 2004 date is not supported by any credible record evidence relating to market
21 power resolution and mitigation. The July 1, 2004 date does equate to the period of stay suggested
22 by Tucson Electric Power Company (“TEP”) in connection with its currently pending Request for
23 Variance. [Opinion and Order, page 6, lines 7 - 9] However, that expressed preference has no
24 functional bearing on or probative relationship to the amount of time required to arrive at a
25 “workably competitive market” condition, including time for completion, submission and evaluation
26 of the market power studies and mitigation measure proposals contemplated in the recommended
27 Opinion and Order.

1 Second, to the extent that the transfer or divestiture of generation assets represents a
2 condition precedent to subjecting to competitive procurement that portion of Arizona Public Service
3 Company's ("APS") or TEP's Standard Offer ("SO") power requirements that would otherwise be
4 served from their "own existing assets," it represents an artificial barrier or impediment to the scope
5 and pace at which the desired "phase-in to competition" can and should occur. The relevant facts
6 to be considered in this regard are (i) the degree and nature of progress which are achieved in the
7 Track "B" portion of these consolidated proceedings, and (ii) the extent to which existing and near
8 term transmission facilities can be used to deliver competitive power to UDCs. The progress and
9 results of the Track "B" workshop conducted at the Commission's offices on July 24-25, 2002, are
10 very encouraging; and Sempra/ SWPG anticipate further significant progress will be achieved at the
11 workshop scheduled for August 13-14, 2002. The results of this ongoing effort will, to a large
12 extent, determine the amount and timing of future competitive solicitations by APS and TEP, and
13 it would be unwise for the Commission to prejudge the outcome of the Track "B" workshops in its
14 Track "A" Order. Moreover, as indicated in both the Track "A" proceedings, and the Track "B"
15 workshop, there are no existing physical transmission limitations that suggest competition could not
16 be introduced during 2003 to serve some portion of APS's and TEP's existing SO load.
17
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21 Third, and supportive of the immediately preceding criticism, is the following quotation from
22 the CALJ's recommended Opinion and Order:

23 "... effective upon implementation of the outcome of Track B, we
24 will require APS and TEP to acquire, at a minimum, any required
25 power that cannot be produced from its own existing assets, through
26 the competitive procurement process as developed in the Track "B"
27 proceeding. The amount of power, the timing, and the form of
28 procurement shall be determined in the Track B proceeding. . ."
[Opinion and Order, page 23, lines 15-19] [emphasis added]

1 What this language clearly suggests is that APS's and TEP's ownership of generation assets does
2 not, and should not, erect an arbitrary or artificial barrier beyond which the competitive procurement
3 process cannot extend or penetrate. Rather, the only barriers to such extension or penetration are
4 those arising from unresolved market power situations and the risks of price instability and service
5 unreliability which it may occasion.
6

7 **C. A Suggested Clarification or Correction.**

8 The problems discussed in the preceding subsection can be easily addressed in the following
9 manner. First, the words "until at least July 1, 2004" should be deleted from all places at which they
10 appear in the CALJ's recommended Opinion and Order. These include (i) page 23, line 12, (ii)
11 Finding of Fact No. 35, at page 29, line 13 and (iii) the First Ordering Paragraph, at page 31, line 21.
12 Second, the Opinion and Order should be modified to clarify that the extent to which APS's and
13 TEP's power requirements are to be subjected to the competitive procurement process will be
14 determined by the (i) the pace and degree of development of a competitive procurement process or
15 processes in the Track "B" proceeding, and (ii) the degree and pace of resolution or mitigation of
16 market power problems as a result of Track "A," and not on the basis of APS and TEP ownership
17 of generation assets. Such clarification should include, at a minimum, language changes to (i) page
18 23, lines 15-19, (ii) Finding of Fact No. 36, at page 29, lines 18-21, (iii) the Third Ordering
19 Paragraph at page 31, line 27 - page 32, line 3, and (iv) the Fourth Ordering Paragraph at page 32,
20 lines 4-8.
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III.

THE LANGUAGE OF THE RECOMMENDED OPINION AND ORDER SHOULD BE MODIFIED TO CLARIFY AND PROVIDE THAT THE PHRASE "COMPETITIVE PROCUREMENT PROCESS" INCLUDES THE PROCUREMENT OF POWER THROUGH PRUDENT, ARM'S LENGTH BILATERAL CONTRACTS RESULTING FROM PRUDENT, ARM'S LENGTH NEGOTIATIONS

In a sense, the title of this section succinctly states the point Sempra/ SWPG wish to make, namely, that nothing contained in any Commission decision on Track "A" issues should preclude any competitive procurement process developed and implemented under the auspices of Track "B" from including the use of bilateral contracts as a means of serving APS's and TEP's requirements for power from the competitive wholesale market. A.A.C. R14-2-1606(B), in its present form, includes a reference to "prudent, arms length transactions" as well as "a competitive bid process." The former characterizes the setting in which bilateral agreements are conceived and consummated; and Sempra/ SWPG believe that the CALJ did not intend to exclude such agreements or that phrase from the scope of the phrase "competitive procurement process." However, a clarification to that effect would be helpful for all concerned.

Such clarification could be provided by adding the following sentence at several places within the recommended Opinion and Order: "As used herein, the phrase 'competitive procurement process' includes bilateral contracts resulting from prudent, arm's length negotiations." This sentence could be inserted in the following locations in order to accomplish the desired clarification: (i) on page 23, line 18, after the sentence ending with the words "as developed in the Track B proceeding"; (ii) on page 29, line 21, at the end of Finding of Fact No. 36; (iii) on page 32, line 3, at the end of the Third Ordering Paragraph; and (iv) on page 32, line 8, at the end of the Fourth Ordering Paragraph.

IV.

MISCELLANEOUS

Several miscellaneous matters addressed in the CALJ's recommended Opinion and Order also warrant comment.

First, Sempra/ SWPG support the CALJ's recommendations with regard to the modification by APS and TEP of their respective Codes of Conduct in the manner recommended by the Commission's staff. In that regard, Sempra/ SWPG intend to request copies of, and review for possible comment, such proposed modifications as APS and TEP may file.

Second, Sempra/ SWPG further support the CALJ's recommendations relating to the development of a plan by APS, TEP and the Commission's Staff to resolve reliability must-run generation concerns. In that regard, Sempra/ SWPG believe that language should be added to the Sixth and Seventh Ordering Paragraphs providing that interested persons (such as Sempra / SWPG) will have an opportunity to review and comment upon such plan(s), and related RMR generation strategies before they are finalized. As the record in the Track "A" proceedings indicates, and as the Track "B" workshops will disclose, there is a direct relationship between the amount of RMR generation capacity owned and operated by UDC's and the amount of their SO load otherwise available for service from the competitive market. Thus, merchant plant owners have a direct and substantial interest in being involved in these matters.

Third, Sempra/ SWPG also support the CALJ's recommendation regarding the formation of an Electric Competition Advisory Group.

1 Fourth, Sempra/ SWPG concur with the CALJ's recommended Finding of Fact No. 43,
2 which states,

3 "The issue of transferring PWEC's generation assets is not the subject
4 of this Track A proceeding, and there is not sufficient evidence, nor
5 have the parties had an opportunity to present evidence on the issue.
6 If APS wishes to pursue this issue, it should file the appropriate
applications."

7 The CALJ is correct in each of her conclusions. Moreover, in the event APS and or PWEC should
8 file such application(s) at some future date, Sempra/ SWPG anticipate they will (i) seek leave to
9 intervene, and (ii) if intervention is granted, raise the issue of whether the public interest might not
10 be better served by allowing for the sale of the generation assets in question at the highest price to
11 any qualified bidder, and not just acquisition by APS.
12

13 Fifth, at footnote 9 on page 23, the following statement appears:

14 "The Commission will closely monitor APS' power procurement for
15 potential affiliate concerns until the Track B competitive procurement
16 process is implemented."

17 Even though the proposed expansion of the Springerville generation station has not as yet been
18 approved, the text and thrust of this footnote should be expanded to encompass TEP's power
19 procurement activities as well. During the Track "A" hearings, TEP witness Pignatelli testified TEP
20 did not intend to procure power directly from Springerville Units 3 and 4, if constructed. However,
21 he left open the possibility power produced by Units 3 and 4 might be procured through an affiliate
22 of TEP. Given this, the expansion of the footnote suggested herein is clearly warranted.
23

24 Sixth, the recommended Opinion and Order states that

25 "We believe that both transmission providers and merchant power
26 plants should share the burden and obligation to resolve Arizona's
27 transmission constraints." [Opinion and Order, page 25 lines 18-20]
28

1 This statement is incomplete and potentially troublesome. More specifically, the statement is unclear
2 as to how improvements to Arizona's EHV transmission system will be paid for and how such costs
3 will be recovered. At present, Arizona consumers of electricity ultimately pay for the costs of
4 maintaining and improving Arizona's EHV transmission system through the rates they pay. The
5 introduction of competition was not intended to alter that responsibility, and it should not. However,
6 the phrase "share the burden" is ambiguous in this regard. The language should be clarified to
7 indicate that no transfer of the traditional cost recovery responsibility is intended.
8

9
10 V.

11 CONCLUSION

12 Sempra/ SWPG appreciates the opportunity to submit the foregoing comments and
13 suggestions. They will have a representative in attendance at any Open Meeting(s) the Commission
14 may conduct incident to its consideration of the CALJ's recommended Opinion and Order, in order
15 to answer any questions the members of the Commission may have regarding these exceptions.
16

17 Dated: August 1, 2002

18 Respectfully submitted,
19 SEMPRA ENERGY RESOURCES

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All parties of record

